No. 05-128

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IN THE

Supreme Court of the United States

HOWARD DELIVERY SERVICE, INC., *et al.*,

Petitioners,

v.

ZURICH AMERICAN INSURANCE CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner's Rule 29.6 Statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that Statement.

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REPLY BRIEF FOR PETITIONERS

Section 507(a)(4) of the Bankruptcy Code grants a fourth priority to claims for "contributions to an employee benefit plan – arising from services rendered within 180 days before the date of the filing of the petition[.]" 11 U.S.C. § 507(a)(4). The only issue in this case is whether Zurich's claim for unpaid premiums due under the workers' compensation insurance policy issued to Howard is entitled to such priority. Zurich's argument proposes an inappropriately expansive reading of the "plain language" of § 507(a)(4), in derogation of the fundamental principles underlying the Bankruptcy Code. Such a broad reading of § 507(a)(4) does not comport with the overriding bankruptcy principle calling for equality of distribution among creditors, and the legislative history confirms that Zurich's claim is not entitled to priority.

A. Broadening the scope of § 507(a)(4) to include claims for unpaid workers' compensation insurance premiums is not appropriate.

This Court has on several occasions considered the scope of claim priorities contained in § 507(a) of the Bankruptcy Code, and, on each occasion, the Court has recognized that equality of distribution is the guiding principle that governs our bankruptcy system. *See Nathanson v. NLRB*, 344 U.S. 25, 29 (1952); *United States v. Embassy Rest. Inc.*, 359 U.S. 29, 31 (1959); *Joint Indus. Bd. v. United States*, 391 U.S. 224, 228 (1968). Under this general principle, all claims of a similar nature, such as unsecured claims, will share equally in the distribution of assets. When an unsecured claim qualifies for priority under one of the provisions of § 507(a), it automatically is elevated above other similar but

unqualified unsecured claims, which would otherwise be entitled to share equally in the distribution of available assets but for the statutory priority. Bankruptcy priorities represent the exceptions to the general rule of equality of distribution, and they accordingly are disfavored under the law.

Every claim that is granted priority directly reduces the funds available to general unsecured creditors. *Joint Indus. Bd.*, 391 U.S. at 228; *Ohio Bureau of Workers' Comp. v. Yoder (In re Suburban Motor Freight, Inc.)*, 36 F.3d 484, 487 (6th Cir. 1994). Claims granted priority also dilute the recovery of other priority claims of equal or lesser priority. For these reasons, it is essential that "statutory priorities are narrowly construed." *Trustees of the Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 100 (2nd Cir. 1986). The principle that priorities are exceptions to the general rule of equality of distribution requiring narrow construction is well settled, and Respondent does not seriously challenge it as a general proposition.[1]

Instead, Respondent argues against a narrow construction of § 507(a)(4) by characterizing the narrow construction rule

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1. In analogous situations, this Court has held that exceptions to general statutory provisions should be interpreted narrowly. *See, e.g., Commissioner v. Clark*, 489 U.S. 726, 739 (1989) ("In construing provisions [of the Internal Revenue Code] such as § 356, in which a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision."); *A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945) ("To extend an exemption [to the wage and hour provisions of the Fair Labor and Standards Act of 1938] to other than those plainly and unmistakably within its terms and spirit is to abuse the interpretive process and to frustrate the announced will of the people.").

as "arbitrary" and Petitioners' reliance on it as "based on a faulty premise." Resp't Br. 36. In addition, Respondent tries to avoid application of the narrow construction rule by simply rephrasing the issue from whether Respondent's claim is entitled to priority over other claims to the circular and evasive question of whether it is entitled to share equally with other unsecured creditors whose claims do, in fact, qualify for priority treatment. *Id.* Restating the question in this manner merely begs the question of whether Respondent's claims are entitled to any priority. It does not negate the governing rule that all priorities must be narrowly construed.

Respondent's public policy argument similarly rests upon a circularity. It argues that its asserted right to priority treatment is bolstered by the important role played by providers of insurance coverage for workers' compensation benefits. Resp't Br. 44-50. Yet, the same argument can be made for all general unsecured creditors that have provided valuable goods and services to the debtor on credit. Lower courts have squarely identified and rejected the inherently circular nature of Respondent's argument:

> "[T]he insurance companies argue that preferential payment of their premiums is necessary to ensure the financial viability of the workers' compensation insurance industry. This argument, however, could easily be made by any creditor. In today's complex business marketplace, every business might necessarily have to rely on the prompt payment of bills to ensure its own financial stability. Yet, the very fact that the

> bankruptcy code exists is testament to the fact that businesses will sometimes not be in the position to satisfy their debts."

Mfr. Alliance Ins. Co. v. Satriale (In re Allentown Moving & Storage, Inc.), 214 B.R. 761, 766 (E.D. Pa. 1997) (quoting *In re Arrow Carrier Corp.*, 154 B.R. 642, 646 (Bankr. D.N.J. 1993)).

Most bankruptcies have creditors who can assert that their claims should be entitled to priority treatment because they have provided "benefits" to "employees" under some form of "plan." For example, using Respondent's logic, the contractor who installs OSHA-required factory equipment designed to provide a safer workplace, the printing company that prints employee health care manuals, and the insurance provider that writes a general liability policy covering the company vehicles would be entitled to priority treatment. Such a result "would turn on its head the traditionally egalitarian manner in which the Bankruptcy Code has dealt with competing creditors, who by definition fight over very limited assets." *Yoder v. Ohio Bureau of Workers' Comp. (In re Suburban Motor Freight, Inc.)*, 998 F.2d 338, 341 (6th Cir. 1993).

Respondent's arguments ignore this Court's holding in *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952), that "if one claimant is to be preferred over others, the purpose should be clear from the statute." *Accord Embassy Rest.*, 359 U.S. at 31; *Matter of Jartran, Inc.*, 732 F.2d 584, 586 (7th Cir. 1984) (affirming that "priority should not be afforded unless it is founded on a clear statutory purpose"). If Congress had intended to include statutorily-mandated workers' compensation insurance programs within the definition of

"employee benefit plans," it would have done so using plain and unambiguous language in § 507(a)(4), or it would have granted expressly a priority to workers' compensation claims, as it did when it amended the Bankruptcy Act in 1934 to give workers' compensation claims a seventh level priority and wages a fourth level priority. *Embassy Rest.*, 359 U.S. at 32. Although the Fourth and Ninth Circuits have ruled otherwise, the Sixth, Eighth and Tenth Circuits have each found that Congress did not grant such a priority pursuant to § 507(a)(4). Accordingly, as this Court reasoned when the issue was whether fringe benefits such as contributions to an annuity plan were entitled to priority, "[i]f there is still any question as to whether claims for unpaid contributions to provide deferred benefits to employees should share the assets of bankrupts with general creditors or should be entitled to the limited priority granted wages due to workmen, any new resolution of that question should come from Congress." *Joint Indus.*, 391 U.S. at 229. There simply is no basis consonant with the general principle of equality of treatment of creditors for expanding the scope of § 507(a)(4) to include claims for unpaid workers' compensation insurance premiums.

B. The legislative history confirms that Congress intended to limit § 507(a)(4) to fringe benefits.

Respondent similarly does not adequately rebut the argument (and finding by Judges Shedd and Niemeyer of the Fourth Circuit) that the phrase "contributions to an employee benefit plan arising from services rendered" is ambiguous in the context of § 507(a)(4). The Bankruptcy Code does not define these terms, either separately or as used collectively in § 507(a)(4). Moreover, Respondent fails to address the fact that the Sixth, Eighth and Tenth Circuits, on the one

hand, and the Fourth and Ninth Circuits, on the other, have reviewed these terms and reached opposite conclusions as to their meaning, a strong indication that there may be more than one reasonable interpretation of the language of Section 507(a)(4). *See State Ins. Fund v. Southern Star Foods, Inc.* (*In re Southern Star Foods, Inc.*), 144 F.3d 712, 715 (10th Cir. 1998) ("The split in the circuits is, in itself, evidence of the ambiguity of the phrase 'contributions to an employee benefit plan[.]'"). To clarify any such ambiguity, the Court should review the legislative history of § 507(a)(4).[2]

While Respondent accuses Petitioners of relying on mere "snippets" of legislative history,[3] there is, in fact, an abundance of legislative history supporting the conclusion that Congress simultaneously amended § 507(a)(3) and added § 507(a)(4) with the express intent of providing employees greater priority treatment for their direct wages and "all other forms of employee compensation that is not in the form of wages[,]" *i.e.*, fringe benefits. H.R. Rep. No. 95-595, at 357 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6313. Furthermore, ample authority exists in the legislative history to contradict Respondent's assertions[4] that § 507(a)(4) was not intended to "overrule" *Embassy Restaurant* and *Joint Industry* or to supplement the reach of § 507(a)(3) so as to encompass fringe benefits.[5] The Commission Report on what

2. *See also Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 255 (1992) ("Whenever there is some uncertainty about the meaning of a statute, it is prudent to examine its legislative history.") (Stevens, J., concurring).

3. Resp't Br. 31.

4. Resp't Br. 32.

5. *See* Pet'r Br. 33-35.

became the Bankruptcy Act of 1978 explained the newly proposed § 507(a)(4)[6] as follows:

> For the same reason as that justifying a priority for wages paid directly to the employee, the Commission also recommends that the priority be extended to include fringe benefits. Fringe benefits are now considered part of the basic wage package that an employee receives from his employer. As pointed out by Mr. Justice Black, dissenting in *United States v. Embassy Restaurant, Inc.*, "It is hard . . . to see how they could not be 'wages.' The payments are certainly not gifts." Union negotiators agree to smaller direct wages in exchange for greater fringe benefits.

Report of the Comm'n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess. (1973), *reprinted in* COLLIER ON BANKRUPTCY App. 4(c) 4-479 through 4-480.

The Commission Notes to § 507(a)(4) make clear that the new provision was intended to "overrule" *Joint Industry* and *Embassy Restaurant*, so that "[t]he longstanding dispute as to whether fringe benefits should be considered wages is mooted." *Id.* at 4-680. Furthermore, the Commission Notes state that the new priority provision "gives fringe benefits a priority behind wages, thus disposing of one of the policy reasons for the *Embassy* case, *i.e.*, that fringes payable might compete with and reduce payments of wage claims." *Id.* at 4-680 through 4-681. The legislative history thus leaves little doubt that Congress intended the phrase "employee benefit plans" in § 507(a)(4) to refer to fringe benefits that

6. The provision was originally designated as § 4-405(a)(4).

were included as part of a "wage package" negotiated (either explicitly or implicitly) between employer and employee, and not to statutorily-mandated workers' compensation coverage over which neither employer nor employee had any control.

Respondent and its Amici Curiae nevertheless seek to push the meaning of "employee benefit plan" beyond its intended scope by citing to the testimony of various witnesses who recommended that Congress change the proposed language "pension, insurance or similar employee benefit plans" to simply "employee benefit plans." While it is true that certain witnesses raised concerns that the originally proposed language might define the scope of "employee benefit plans" too narrowly, the testimony in question does not logically support the inclusion of workers' compensation with the type of employee benefit plans that were being addressed.

For example, when Max Zimny, General Counsel, International Ladies Garment Workers Union, AFL-CIO, testified about the qualifying phrase "pensions, insurance or similar employee benefit plans" that was initially proposed for § 507(a)(4), he noted that this language might not be broad enough to include "benefits like scholarships, prepaid legal plans, daycare centers, apprenticeship training and the like[.]" Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary (the "Subcommittee Hearing Report"), 94th Cong. (1976) at 2431-32 (Testimony of Max Zimny, International Ladies Garment Workers Union, AFL-CIO). Mr. Zimny explained that these types of plans were already included in Section 302(c) of the Labor-Management Relations Act "as fringe benefits subject to collective bargaining" and that the list of such bargained-for benefits would continue to grow. *Id.* at 2425.

Mr. Zimny went on to explain the nature of these fringe benefits as wage substitutes:

> [W]ages cover not only direct take-home pay. When unions and employers negotiate, they negotiate a total wage package which is then divided, depending on the particular circumstances of the industry and of the times, into so much for direct take-home pay and so much for medical, dental, legal, pension, and other employee benefit coverage. . . . But wages are as truly one as they are the other.

Id. at 2427.

Conspicuously absent from any of the testimony or statements in the legislative history is a suggestion by any of the witnesses that workers' compensation benefits should be included within the definition of "employee benefit plans." To the contrary, each of the witnesses focused on the need to structure § 507(a)(4) so as to permit the future inclusion of new forms of negotiated fringe benefits, such as those identified by Mr. Zimny. Not one of these witnesses suggested that workers' compensation benefits should be included in the priority provision.

Indeed, it appears that Jeffrey Gibbs, Counsel, Industrial Union Department, AFL-CIO, made the only direct reference to workers' compensation benefits. But, he did so to *distinguish* negotiated fringe benefits from statutory benefits. Thus, Mr. Gibbs first lauded the protections that already had

been granted through statutory benefits under federal and state laws:

> Since 1926 we have seen a spectacular increase in government interest and support of federal and state legislation and programs to increase the protection of the worker against the ravages of economic displacement. Unemployment compensation and workmen's compensation laws have been enacted throughout the country, and benefits for those programs have been raised on a regular basis.

Id. at 2434 (Statement of Jeffrey Gibbs). He then contrasted the gains made on this statutory front with the lack of comparable gains to protect wages and fringe benefits under the bankruptcy laws. *Id.* at 2435. The only possible interpretation of this particular testimony, and of the absence of any other discussion of workers' compensation in connection with § 507(a)(4), is that the witnesses did not consider workers' compensation benefits to be within the scope of the "employee benefit plans" that Congress was addressing with respect to the amendments to the priority provisions of the Bankruptcy Code.

Finally, Respondent's argument that § 507(a)(4) should be read to encompass unpaid workers' compensation insurance premiums, regardless of its lack of evidence of Congressional intent and the lack of a compelling plain meaning that requires Respondent's interpretation, must fail. Respondent cites several cases for the proposition that "broad statutory language may not be construed narrowly merely because it encompasses situations in addition to those on which Congress focused at the time of enactment." Resp't

Br. 15. This reliance on those cases is misplaced for several reasons.

First, none of the cited cases involved the interpretation of claim priorities which, as previously discussed, must be read narrowly and not broadly. Second, in each of the cases cited, this Court found the language of the statute to be clear on its face. For example, in *Union Bank v. Wolas*, 502 U.S. 151, 155 (1991), the Court held that the statutory language of § 547(c)(2) (ordinary course of business defense to preference actions) made no distinction between payments on long-term and short-term debt and thus both fell within the defense. Similarly, in *Toibb v. Radloff*, 501 U.S. 157, 160-161 (1991), this Court held that the language in § 109 (defining who may be a debtor under the various chapters of the Bankruptcy Code) did not contain an ongoing business requirement for relief under Chapter 11, and that an individual debtor not engaged in business therefore was eligible for relief under Chapter 11. *See also Patterson v. Shumate*, 504 U.S. 753, 761 (1992) (finding that the clarity of the statutory language "applicable nonbankruptcy law" in § 541 did not require a review of the legislative history); *FCC v. NextWave Pers. Comm., Inc.*, 537 U.S. 293 (2003) (finding that the language of § 525(a) clearly prohibits revocation of broadband personal communications service licenses issued by the FCC for nonpayment).

In each of these cases, the Court ultimately held that the statutory language was clear. Those holdings mean little if the Court determines that the language of § 507(a)(4) is ambiguous, in which case the Court must consider Congressional intent. At that point, legislative intent should control and the cases relied upon by Petitioner become inapposite. When reviewed as a whole, the legislative history

clearly illuminates Congress' intent in enacting § 507(a)(4) – to provide employees greater priority treatment for their direct wages and their negotiated fringe benefits.

CONCLUSION

Section 507(a)(4) of the Bankruptcy Code establishes a priority for "contributions to an employee benefit plan arising from services rendered" as an exception to the general rule in bankruptcy of equality of distribution. It cannot be broadened arbitrarily to include unpaid premiums for statutorily mandated workers' compensation insurance coverage. Expanding the scope of § 507(a)(4) in this manner should not be done absent a compellingly clear plain meaning of the statute, which does not exist, or clear Congressional intent, which similarly does not exist. To the contrary, it is clear from the legislative history that Congress never intended to afford priority treatment to unpaid workers' compensation insurance premiums. This priority, like all bankruptcy priorities, must be narrowly construed.

For all of the reasons stated herein, Howard and the Committee respectfully request that this Court reverse the decision of the Fourth Circuit and deny priority treatment to Zurich's claim for unpaid insurance premiums.

Respectfully submitted,

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